

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended December 31, 2013



JOHN CHIANG
California State Controller

July 2014



JOHN CHIANG
California State Controller

July 11, 2014

John Smolin, Chairperson
California Lottery Commission
700 North Tenth Street
Sacramento, California 95811

Dear Mr. Smolin:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to the public education community for the quarter ended December 31, 2013. Our analysis found that the transfer amount of \$358,623,021 appears to be supported by the Lottery's accounting records and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/mh

cc: Gregory Ahern, Commissioner
California Lottery Commission
Nathaniel Kirtman III, Commissioner
California Lottery Commission
Rowena Libang-Bobila, Commissioner
California Lottery Commission
Connie M. Perez, Commissioner
California Lottery Commission
Paula D. LaBrie, Acting Director
California Lottery
Nicholas Buchen, Deputy Director, Finance
California Lottery
Roberto Zavala, Chief Internal Auditor
California Lottery

Contents

Report of Analysis

Summary	1
Introduction	1
Background	1
Objectives, Scope, and Methodology	2
Results.....	2
Schedule 1—Fiscal Years 2013-14 and 2012-13 Quarter-End Lottery Revenue Allocations.....	3
Attachment—California Lottery’s Transfer Request of February 21, 2014	

Report of Analysis

Summary

In a letter dated February 21, 2014, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$358,623,021 to the Lottery Education Fund for disbursement to the public education community. Our analysis found that the transfer amount appears to be supported by the Lottery's accounting records and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

On March 28, 2014, the SCO transferred \$358,623,021 to the Lottery Education Fund.

Introduction

This report presents the results of our analysis of the Lottery's quarterly request that the SCO transfer funds to the public education community. This analysis is part of our responsibility under the California State Lottery Act (Lottery Act). We performed this analysis to determine if the transfer amount to the public education community was supported by amounts recorded in the Lottery's accounting records and to determine if the Lottery is on target to comply with the annual Lottery Education Fund allocation requirements contained in the Lottery Act.

Background

In 1984, California voters passed an initiative, which by amending the State Constitution, authorized a state-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of net revenues to the public education community and established the allocation percentages for lottery funds. The Lottery Act also requires the SCO to conduct quarterly and annual post-audits of all accounts and transactions of the California Lottery Commission and other special post-audits as the State Controller deems necessary.

The Lottery Act was amended by Assembly Bill 142 on April 8, 2010. The bill was an urgency statute that went into effect immediately. Assembly Bill 142 requires revenues from the Lottery to be allocated to maximize the amount of funding allocated to the public education community. The bill requires that not less than 87% of the total annual revenues from Lottery ticket sales be returned to the public in the form of prizes and funds to education and not more than 13% be allocated for Lottery expenses. The bill specified that not less than 50% of the total annual Lottery revenues, in an amount to be determined by the Lottery Commission, be returned to the public in the form of prizes. In addition, the bill requires the Lottery Commission to establish the percentages to be allocated to the benefit of public education.

Each quarter, the Lottery requests that the SCO transfer net revenues to the public education community (see Attachment). The Lottery's request usually occurs eight to ten weeks after the close of the quarter.

Objectives, Scope, and Methodology

We performed this analysis of the transfer of funds to the public education community for the quarter ended December 31, 2013, in order to determine if:

- The Lottery's requested transfer amount of \$358,623,021 is supported by accounting records; and
- The Lottery is on target to comply with the annual allocation requirements specified in the Lottery Act.

As part of our analysis, we traced the transfer amount to the Lottery's accounting records and applied analytical review procedures to Lottery fund accounts by comparing them with those from the prior year.

Results

On March 28, 2014, the SCO transferred \$358,623,021 to the Lottery Education Fund.

After analyzing the Lottery's unaudited financial statements and supporting records for the quarter ended December 31, 2013, we determined that the Lottery's requested transfer amount of \$358,623,021 to the Lottery Education Fund appears to be supported by accounting records.

For the quarter ended December 31, 2013, of the total revenues from ticket sales:

- 60.45% was returned to the public in the form of prizes;
- 27.29% was transferred to the public education community; and
- 12.26% was used for administrative expenses.

The Lottery returned 87.74% of the total revenues from the sales of tickets to the public in the form of prizes and funds to education. The Lottery is on target to comply with the annual allocation requirements specified in the Lottery Act. See Schedule 1 for a summary of Lottery transfers and allocation percentages.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

July 11, 2014

Schedule 1— Fiscal Years 2013-14 and 2012-13 Quarter-End Lottery Revenue Allocations

Fiscal Year 2013-14	Quarter Ended							
	9/30/2013	% of Sales ¹	12/31/2013	% of Sales ¹	3/31/2014	% of Sales ¹	6/30/2014	% of Sales ¹
Sales	\$ 1,162,247,646	100.00%	\$ 2,450,157,700	100.00%	\$	%	\$	%
Prizes	\$ 699,802,713	60.21%	\$ 1,481,034,292	60.45%	\$	%	\$	%
Operating income to education	318,010,935	27.36%	668,711,181	27.29%		%		%
Revenues returned to public	\$ 1,017,813,648	87.57%	\$ 2,149,745,473	87.74%	\$	%	\$	%
Administrative expenses	\$ 144,433,998	12.43%	\$ 300,412,227	12.26%	\$	%	\$	%
Miscellaneous income ²	\$ 3,669,263		\$ 11,592,038		\$		\$	
Adjustment	\$ 5,720,287 ⁴		\$ —		\$		\$	
Allocation to Education Fund ⁵	\$ 327,400,485		\$ 680,303,219		\$		\$	

Fiscal Year 2012-13	Quarter Ended							
	9/30/2012	% of Sales ¹	12/31/2012	% of Sales ¹	3/31/2013	% of Sales ¹	6/30/2013	% of Sales ¹
Sales	\$ 1,008,382,162	100.00%	\$ 2,051,515,833	100.00%	\$ 3,153,730,899	100.00%	\$ 4,445,874,040	100.00%
Prizes	\$ 611,579,884	60.65%	\$ 1,245,909,894	60.73%	\$ 1,900,093,870	60.25%	\$ 2,652,095,102	59.65%
Operating income to education	277,570,269	27.53%	561,004,433	27.35%	883,957,405	28.03%	1,260,789,450	28.36%
Revenues returned to public	\$ 889,150,153	88.18%	\$ 1,806,914,327	88.08%	\$ 2,784,051,275	88.28%	\$ 3,912,884,552	88.01%
Administrative expenses	\$ 119,232,009	11.82%	\$ 224,601,506	11.92%	\$ 369,679,624	11.72%	\$ 532,989,488	11.99%
Miscellaneous income ²	\$ 10,591,621		\$ 15,064,526		\$ 19,693,087		\$ 23,581,329	
Adjustment	\$ 4,715,142 ⁴		\$ —		\$ —		\$ (5,720,287) ³	
Allocation to Education Fund ⁵	\$ 292,877,032		\$ 576,068,959		\$ 903,650,492		\$ 1,278,650,492	

Annual Statutory Revenue Allocation Percentage Requirements

Prizes – Not less than 50% of sales

Administrative expenses – Not more than 13% of sales

Prizes and funds to education – Not less than 87% of sales

Other income – 100% to education

¹ Statutory compliance is determined on an annual basis at fiscal year-end. The percentages displayed in quarters 1, 2, and 3 are presented to show the Lottery's year-to-date progress towards meeting annual statutory requirements.

² Miscellaneous income includes SMIF interest earned, unclaimed prizes, and other income.

³ This amount was withheld from the fourth quarter transfer and was adjusted in the subsequent quarterly transfer, pending the financial statement audit and resolution of accounting issues.

⁴ This amount was withheld from the previous quarterly transfer and was included in the first quarter's transfer after the completion of the financial statement audit and resolution of accounting issues.

⁵ The Education Fund allocation amount is sales plus miscellaneous income, plus/less the adjustment amount, less prizes, and less administrative expenses.

**Attachment—
California Lottery's
Transfer Request of February 21, 2014**



February 21, 2014

Ms. Casandra Moore-Hudnall, Acting Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Ms. Moore-Hudnall:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$358,623,021. This figure represents:

Operating income for the six months ended December 31, 2013	\$ 668,711,181
SMIF interest earned	614,084
Other income	14,764
Unclaimed prizes	<u>10,963,190</u>
	<u>\$ 680,303,219</u>
Less: Transfer for the three months ended September 30, 2013	\$ 321,680,198
	<u>\$ 358,623,021</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the six months ended December 31, 2013, prepared from books without audit, for your files.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Nicholas Buchen'.

Nicholas Buchen, Deputy Director
Finance Division

Attachment
cc: Paula LaBrie, Acting Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Position
For the Six Months Ending December 31, 2013

Lottery sales	\$2,450,157,700
Prizes	1,481,034,292

Sales after prizes	\$969,123,408

Less game costs:	
Retailer costs	\$167,752,930
On-line game costs	30,986,449
Off-line game costs	14,232,866

Total game costs	\$212,972,245

Income before operating expenses	\$756,151,163

Operating expenses:	
Salaries, wages and benefits	\$29,336,084
Advertising	32,743,502
Promotion, public relations and point of sale	7,019,754
Other professional services	7,103,206
Depreciation and amortization	2,920,576
Other general and administrative expenses	8,316,860

Total operating expenses	\$87,439,982

Operating income	\$668,711,181
Non-operating (expenses) revenues:	
Investment earnings	(\$25,600,721)
Other Income	14,764
Allocation to Education Fund	(669,340,029)

Total non-operating (expenses) revenues	(\$694,925,986)

Changes in net position	(\$26,214,805)
Total net position-beginning of year	102,067,701

Total net position-end of year	<u>75,852,896</u>

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>